

Minutes for September 1, 1966

To: Members of the Board

From: Office of the Secretary

Attached is a copy of the minutes of the Board of Governors of the Federal Reserve System on the above date. 1/

It is not proposed to include a statement with respect to any of the entries in this set of minutes in the record of policy actions required to be maintained pursuant to section 10 of the Federal Reserve Act.

Should you have any question with regard to the minutes, it will be appreciated if you will advise the Secretary's Office. Otherwise, please initial below. If you were present at the meeting, your initials will indicate approval of the minutes. If you were not present, your initials will indicate only that you have seen the minutes.

Chm. Martin	<u>                    </u>
Gov. Robertson	<u>                    </u>
Gov. Shepardson	<u>                    </u>
Gov. Mitchell	<u>                    </u>
Gov. Daane	<u>                    </u>
Gov. Maisel	<u>                    </u>
Gov. Brimmer	<u>                    </u>

1/ Meeting with Presidents of the Federal Reserve Banks.

A meeting of the Board of Governors of the Federal Reserve System with the Presidents of the Federal Reserve Banks was held on Thursday, September 1, 1966, at 2:30 p.m. This was a telephone conference meeting, and each participant was in Washington except as otherwise indicated:

PRESENT: Mr. Robertson, Vice Chairman  
Mr. Shepardson  
Mr. Mitchell  
Mr. Maisel  
Mr. Brimmer

Mr. Kenyon, Assistant Secretary  
Mr. Broida, Assistant Secretary  
Mr. Holland, Adviser to the Board  
Mr. Solomon, Adviser to the Board  
Mr. Molony, Assistant to the Board  
Mr. Fauver, Assistant to the Board  
Mr. Brill, Director, Division of Research  
and Statistics  
Mr. Hexter, Associate General Counsel  
Mr. Leavitt, Assistant Director, Division  
of Examinations  
Miss Eaton, General Assistant, Office of  
the Secretary

Messrs. Ellis, Hayes, Bopp, Hickman, Wayne,  
Patterson, Scanlon, Galusha, Clay, Irons,  
and Swan, Presidents of the Federal Reserve  
Banks of Boston, New York, Philadelphia,  
Cleveland, Richmond, Atlanta, Chicago,  
Minneapolis, Kansas City, Dallas, and San  
Francisco, respectively 1/

Messrs. Bilby and Koptis, Vice Presidents of  
the Federal Reserve Banks of New York and  
St. Louis, respectively 1/

1/ All of these parties were at their respective Reserve Banks, except that President Hickman was in Wheeling, West Virginia, and President Scanlon was in Detroit.

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The purpose of this meeting was to discuss two draft documents that had been telegraphed to the Reserve Bank Presidents earlier in the day; namely, a document entitled "Program for discount administration in the current economic environment" and a proposed letter on that subject to be sent to all member banks.<sup>1/</sup> An earlier draft memorandum, dated August 19, 1966, regarding the coordination of discount administration with other monetary policy instruments, had been discussed at a joint meeting of the Board and the Reserve Bank Presidents held in Washington, D. C., on August 23, 1966.

Vice Chairman Robertson said that the reason for holding a telephone meeting today was that a leak obviously had occurred, as evidenced by an article in the New York Times this morning. That, plus certain other factors, led the Board members to the conclusion that the System should act promptly on the matter. The program now proposed had benefited from the comments made on the earlier proposal at the joint meeting held on August 23, and from the comments subsequently submitted in writing, all of which had been considered carefully. Considerable assistance also had been received from the discount officers of three Reserve Banks--New York, Philadelphia, and Chicago. The result was the proposed program and letter to member banks that had been distributed today. The letter was intended to calm financial markets; to indicate that the discount window was not going to be closed;

<sup>1/</sup> Copies of the documents referred to are appended to these minutes as Attachments A and B.

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to describe the manner in which it was planned to operate the window; and to emphasize the need for obtaining the cooperation of all banks in combatting inflation. At this time it would be desirable to obtain the views of each of the Presidents as to whether they saw problems in the draft documents and if so how they might be corrected. Unsatisfactory as it was to conduct this sort of discussion by telephone, there was no alternative if a statement was to be released to the press this afternoon. It would seem appropriate for Mr. Wayne, as Chairman of the Presidents' Conference, to open the discussion.

President Wayne said he had no particular comments to make with respect to the document describing the program; he had expressed his views on the policy question in writing. Earlier today Governor Robertson had raised with him the question whether the proposed letter to member banks should go out as a Board letter or over the signatures of the Reserve Bank Presidents. He had talked with several of the other Presidents, and found that Messrs. Hayes, Bopp, and Swan agreed with him that unless there was some compelling reason for proceeding otherwise it would be preferable for the letter to go out from the Reserve Banks over the signatures of the Presidents. President Ellis, on the other hand, preferred to have the letter go out over a Board signature, although he did not feel strongly on the point. He (Mr. Wayne) would recommend that immediately after the letter had been released in Washington it be sent to the member banks in each District over the signature of the Reserve Bank President.

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Governor Robertson said the Board would prefer that course if the Presidents were agreeable to it.

President Hickman said that he would go along with the wishes of others on the matter. He recalled, however, that the Presidents had expressed strong reservations about the program when it was discussed at the August 23 meeting.

President Hayes agreed with Mr. Hickman that the Presidents had expressed strong reservations with regard to the original proposal discussed on August 23. He personally had had such reservations because the proposal seemed to him to call for a radical change in the administration of the discount window. What was being discussed now, however, was a revised program and an improved set of documents. Accordingly, he thought that the Presidents' objections to the original proposal did not have too much relevance to consideration of the present question. As he saw it, one basic objective of the revised program was to try to slow down lending activities of the banks, and to his mind that was a useful goal. Also, under the present highly uncertain conditions in financial markets, it was important that the System make a public statement indicating its readiness to meet severe pressures as they arose. There was some feeling in financial markets that the System was trying to choke off all credit expansion, and prompt release of the letter would serve a useful purpose by making clear that such feelings were not valid.

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Turning to the draft letter itself, President Hayes suggested a clarifying change in the language of the second paragraph. He then called attention to the last sentence of the fifth paragraph, which read, "It is recognized that bank adjustment through such loan curtailment will often involve a longer period of time than would be involved in the orderly disposition of securities." The statement was true, and the System's discount officers should keep it in mind, but there might be some question about the desirability of including it in the letter. Vice President Bilby had pointed out to him that it might increase somewhat the difficulties facing discount officers in dealing with banks that tried to take advantage of the statement. However, he (Mr. Hayes) did not feel strongly on the matter.

Governor Robertson said that the Board had felt that the statement would serve a calming purpose by letting bank borrowers, as well as the banks themselves, know that discounting facilities would be available, when necessary, for longer periods than normally. In the Board's judgment that advantage outweighed the disadvantage of any additional burden that might be placed on discount officers. He then suggested a language change to reduce the scope of the problem Mr. Hayes had mentioned.

President Bopp noted that the letter apparently was intended to serve two purposes--to limit bank credit expansion and to offer reassurance on the availability of System discount facilities. In

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his judgment the need for the former was likely to outlast the need for the latter by a considerable margin. Accordingly, to give greater emphasis to the necessity for slowing the expansion in bank loans he would reorganize the letter, in a manner that he then described. Mr. Bopp also suggested a clarifying change in the language of the last paragraph.

President Hayes said he agreed with the premise that the need for restraint was likely to last longer than that for assuagement of fears. At the moment, however, the greater need was for the latter, and he would therefore retain the present organization of the letter.

President Ellis said he thought the proposed letter, as a public relations document, was a substantial improvement over the document discussed on August 23. However, it still left open the basic issue of whether or not the System should attempt to use the discount mechanism to enforce restrictions on a specific type of credit expansion. He did not see anything in either the letter or the description of the program that provided convincing evidence to the effect that business loans were more inflationary than other types of loans. There also was a question concerning the probable reaction of banks. If the member banks took seriously the attempt to restrict use of the window by those that were expanding their loans rapidly, he would expect such banks to be unwilling to risk that discipline and to take whatever steps were necessary to stay away from the discount window. Banks that were contracting their loans were given

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reason to borrow. The principal achievement of issuing the letter, then, would be to exhort banks to reduce the rate of business loan growth.

However, Mr. Ellis said, if the letter was to be issued, he would recommend two changes. First, he would delete from the first sentence of the fifth paragraph the phrase "by reason of shrinkages in deposits or other sources of funds," because he did not think the intent was to restrict the program to banks experiencing such shrinkages. Secondly, he would strike the next-to-last paragraph of the draft letter, saying "Federal Reserve credit assistance to member banks to meet appropriate seasonal, temporary, or emergency demands from their customers will continue to be available as in the past." The "temporary emergency" needs the System would meet were those of the member banks and not of their customers; as written, the paragraph seemed inconsistent with the whole program.

Finally, President Ellis said, since the principal achievement of the letter would be to exhort banks to restrict loan growth, he thought it would be more effective if it came from the Board rather than from the Reserve Bank Presidents. As Mr. Wayne had indicated, however, he (Mr. Ellis) did not feel strongly on that point.

President Swan said he concurred in both of Mr. Ellis' recommendations for changes in the letter.

Governor Robertson suggested that the difficulty in the next-to-last paragraph might be met by substituting the word "needs" for the phrase "demands from their customers."

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President Hickman commented that the draft letter in effect called on banks seeking accommodation at the discount window because of a run-off in their CD's to reduce the rate of expansion in their business loans. In discussions with some of the larger banks in his District he had been told that they were locked in with respect to business loans by commitments to long-standing customers. If those banks were told, in effect, that they would not be allowed to come to the discount window, they were not likely to be calmed. Did the Board wish to leave the matter that way? Had the Board checked with some of the large banks to see whether they could live with such a program?

Governor Robertson replied that he had done some checking and, while banks might be expected to have difficulties, it appeared they could live with the program. One problem was that the extent to which commitments of individual banks were real and binding was not known. In any case, he thought there were enough calming words in the letter to allay any fears the banks had.

President Hickman then asked whether the language of the fifth paragraph might not be softened to some extent.

President Wayne said that he had intended to make the same point. He suggested rephrasing the second sentence of the fifth paragraph to read, "Member banks will be expected to cooperate in the System's efforts to hold down the rate of expansion in business loans, and to employ the discount facilities of Reserve Banks only as consistent with these efforts."

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President Hayes said he was troubled by the suggested elimination of the reference to shrinkages in deposits or other sources of funds; it should be made clear at some point that the discount window was open to meet needs arising in that way. Also, he would be strongly in favor of retaining the next-to-last paragraph.

President Swan suggested that the next-to-last paragraph might be used as the introduction to the fifth paragraph, with appropriate changes in wording.

President Scanlon observed that the principal question he had had related to the fifth paragraph. He would subscribe to President Wayne's suggestion for the second sentence.

President Galusha commented that in general he thought the letter would prove highly useful. Yesterday he had met with representatives of a number of major banks, and was told that they could curtail some lines of credit but needed help in dealing with their large customers. He then suggested a clarifying change in the first sentence of the draft letter.

President Clay said that he thought a good redrafting job had been done and that the documents under discussion today were improved over the earlier document in many respects. If the decision was to proceed with the program, it should be recognized that it represented a substantial change in discount administration. He was not sanguine that anyone really knew what the repercussions at banks and in financial

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markets would be. The letter might be taken as an invitation to banks to use the discount window. Also, he was not sure that the effect would be a calming one.

President Irons said he found the present documents more satisfactory than the draft memorandum discussed earlier. In particular, he was pleased to see the program kept within Regulation A. He was still concerned about the question of allocation of bank credit between business loans and other categories, because he felt that in some cases business loans were not the source of the problems. Also, while business loans were continuing to increase, their recent growth was at a more orderly rate than earlier.

President Irons went on to say that he considered the proposed program to involve a liberalization of discount administration. If banks were to be given that impression, it might be desirable to work into the letter the thought that general monetary and credit policy was unchanged, and that the program would be coordinated with other monetary policy instruments.

Governor Robertson said that the program was not intended to be an easing action in any sense of the word, nor was it a move toward greater restraint. What was sought was a different pattern of impact of the existing degree of restraint.

President Patterson expressed agreement with the suggestions made by Messrs. Wayne and Galusha. He still thought that there would

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be quite a problem of administering the discount window under the proposed program.

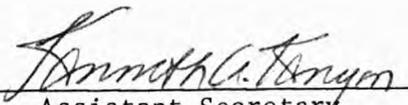
Vice President Koptis said the St. Louis Bank had felt that the existing problem could be dealt with under Regulation A, and he was happy to see that the proposal stayed within the terms of the Regulation. He thought the suggestions that had been made today for editorial changes in the draft were desirable.

Some further discussion followed regarding the organization and content of the draft letter, relating particularly to the material included in the fifth and next-to-last paragraphs of the draft.

Governor Robertson then indicated that a final version of the letter would be prepared immediately, taking account of the suggestions made. If there were no objections, the letter would be wired to the Reserve Banks for reproduction over the signature of the respective Presidents and mailing to the member banks; and it would be released to the press at the Board this afternoon. No objections were heard.

Secretary's Note: A copy of the Board's press statement is appended to these minutes as Attachment C.

The meeting then adjourned.

  
Assistant Secretary

FOR INTERNAL SYSTEM USE ONLY

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PROGRAM FOR DISCOUNT ADMINISTRATION  
IN THE CURRENT ECONOMIC ENVIRONMENT

In contrast to a somewhat reduced rate of expansion for most monetary and credit magnitudes thus far this year, bank loans to businesses have expanded at an extraordinary pace. This development needs to be taken into account, insofar as feasible, in the application of all instruments of monetary policy, including discount policy.

In the current business and financial situation, the amount of borrowing by member banks from their respective Reserve Banks may increase substantially. This is expected to result from the interaction of strong credit demands and current System policies with respect to open market operations, reserve requirements and maintenance of Regulation Q ceilings, with attendant possibilities of substantial run-offs in CD's or declines in other types of deposits, and perhaps also occasional drying up of sources of inter-bank borrowing.

In this environment, accommodation of banks at the discount window should take into account the need to curtail bank lending to the business sector of the economy. Furthermore, this accommodation should recognize that bank adjustment through such loan curtailment probably involves a longer period of time than through the orderly disposition of securities. At the same time, it is desirable that bank efforts to adjust their positions in response to pressures on the banking system do not result in a demoralization of any other financial markets where bank influence is of significant importance (e.g., the municipal market).

It is believed that Federal Reserve Bank discount administration can help to accomplish the desired objectives, within the framework of the present Regulation A. It is likely that in those situations where there is a sharp run-off of CD's or a drying up of inter-bank sources of funds, it may be necessary, as the Regulation in fact has anticipated,<sup>1/</sup> to lend to banks for somewhat longer than usual periods of time. Such longer periods of credit extension would permit the borrowing bank to make some orderly serial adjustment in the area of business loans rather than concentrating its adjustments in such other earning assets as municipal and agency securities, real estate mortgages, and other loans.

While discount officers should refrain from urging specific decisions upon member banks, they should nevertheless urge the desirability of undertaking adjustments in business loan totals. In any case, it should be made clear--again in accordance with the present Regulation<sup>2/</sup>--that expansion of business loans at current rates is not in the public interest and will not be condoned while the member bank is in a position of having to borrow from the Federal Reserve Bank.

Indicated demands for industrial credit during the next few months are such that it is altogether likely that member banks will have to forego loans to some well-established prime customers. It

<sup>1/</sup> ". . . Federal Reserve credit is also available for longer periods when necessary in order to assist member banks in meeting unusual situations, such as may result from national, regional, or local difficulties or from exceptional circumstances involving only particular member banks. . . ." Regulation A, Section 201.0, par. (d).  
<sup>2/</sup> Regulation A, Section 201.0, par. (e), quoted on page 3.

is not intended that System policy shall prevent member banks from meeting legitimate and normal seasonal needs, especially where they have made some preparation to take care of this themselves; it is intended, however, that the seasonally adjusted rate of expansion of business loans shall be reduced. This should not be construed, of course, as any license to expand other types of loans unduly.

The emphasis on slowing down the rate of growth of a particular category of loan--or even achieving some reduction in individual bank cases--is a departure from recent discounting practice and tradition. It is felt to be necessary because of the Board's conclusion that the present rate of expansion of business loans is supporting an unsustainable rate of growth of business investment, with unsound consequences for economic and financial conditions. The Foreword to Regulation A has anticipated this possibility. It specifies that "each Federal Reserve Bank gives due regard to the purpose of the credit and to its probable effects upon the maintenance of sound credit conditions, both as to the individual institution and the economy generally." It is this concern for "sound credit conditions," rooted in the Federal Reserve Act itself, which makes it currently necessary to bring to bear those aspects of discount administration which are designed to deal with unusual circumstances.

While the standards of discount accommodation outlined above can only affect directly those banks that are indebted to the Federal Reserve Banks, the Reserve Bank officials are encouraged to continue to take the initiative in communicating with any other of the larger banks

whose general liquidity position and lending activity are such that they might soon need to borrow from the Federal Reserve. The System's policy and the reasons for it should be explained to them in an effort to encourage them to anticipate their needs and to make adjustments in their lending policies that would be appropriate to the situation.

In addition, the examination function will be asked to pay particular attention to the liquidity position of all member banks. Where appropriate, examination officials might be invited to participate jointly with discount officials in contacts with member banks whose liquidity position and lending activity are out of keeping with the program herein enunciated.

Nothing in this program is intended to modify in any way the existing procedures for extension of Federal Reserve credit to assist member banks in meeting temporary, seasonal or emergency needs under the provisions of Regulation A. Those member banks that, in an easier credit environment, may have obtained seasonal or emergency credit assistance by borrowing from their city correspondents are as eligible for accommodation at the discount window as is a member bank that previously had followed the practice of coming to the Reserve Bank for such assistance.

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TEXT OF PROPOSED LETTER TO ALL MEMBER BANKS

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It is the view of the Federal Reserve System that continued orderly bank credit expansion is appropriate in today's economy. However, that expansion should be moderate enough to help insure that spending--and particularly that financed by bank credit--does not exceed the bounds that can be accommodated by the nation's growing physical resources without aggravating inflationary pressures that are already visible.

While the growth of total bank credit and total bank lending has moderated somewhat as compared with last year, total bank credit has grown at an annual rate of over 8 per cent during the first eight months of this year, and total bank loans at a rate of over 12 per cent. Meanwhile bank lending to business has continued to increase at an annual rate of about 20 per cent.

It is recognized that business demands for bank credit have been particularly intense. While such credit requests often appear justifiable when looked at individually, the aggregate total of credit-financed business spending has tended towards unsustainable levels and to add appreciably to current inflationary pressures. Furthermore, such exceedingly rapid business loan expansion is being financed in part by liquidation of other banking assets and by curtailment of other lending in ways that could contribute to disorderly conditions in other credit markets.

The System believes that the national economic interest would be better served by a slower rate of expansion of bank loans to business within the context of moderate overall money and credit growth. Further substantial adjustments through bank liquidation of municipal securities or other investments would add to pressures on financial markets. Hence, the System believes that a greater share of member bank adjustments should take the form of moderation in the rate of expansion of loans, and particularly business loans.

Accordingly, this objective will be kept in mind by the Federal Reserve Banks in granting credit to those member banks that seek to borrow at the discount window by reason of shrinkages in deposits or other sources of funds. Borrowing banks will be expected to cooperate in reducing the rate of business loan growth--apart from normal seasonal requirements--as part of the orderly adjustment of their positions. It is recognized that bank adjustment through such loan curtailment will often involve a longer period of time than would be involved in the orderly disposition of securities.

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This program is in conformity with the provision in Section 201.0, par. (e) of the Board's Regulation A governing lending to member banks:

"In considering a request for credit accommodation, each Federal Reserve Bank gives due regard to the purpose of the credit and to its probable effects upon the maintenance of sound credit conditions, both as to the individual institution and the economy generally. ..."

Federal Reserve credit assistance to member banks to meet appropriate seasonal, temporary, or emergency demands from their customers will continue to be available as in the past.

Curtailement of the extraordinary rate of business loan expansion is in the interest of the entire banking system and of the economy as a whole. All banks should be aware of this consideration, whether or not they need to borrow from the Federal Reserve. Management of bank resources in accordance with the principles outlined above can make a constructive contribution to sustained economic prosperity, and the Federal Reserve System is confident that the banks will give their whole-hearted support to this effort.

FEDERAL RESERVE PRESS RELEASE

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For immediate release

September 1, 1966

The Board of Governors of the Federal Reserve System today released a letter being sent to all member banks by the Presidents of the twelve Federal Reserve Banks regarding growth in over-all bank credit, the increase in business loan demand, and administration of Federal Reserve credit assistance to member banks through the System's discount facilities. The text of the letter follows:

"It is the view of the Federal Reserve System that orderly bank credit expansion is appropriate in today's economy. However, that expansion should be moderate enough to help insure that spending--and particularly that financed by bank credit--does not exceed the bounds that can be accommodated by the nation's growing physical resources. An excessive expansion of bank credits would aggravate inflationary pressures that are already visible.

"While the growth of total bank credit and total bank lending has moderated somewhat as compared with last year, total bank loans plus investments have grown at an annual rate of over 8 per cent during the first eight months of this year, and total bank loans at a rate of over 12 per cent. Meanwhile, bank lending to business has increased at an annual rate of about 20 per cent.

"It is recognized that business demands for bank credit have been particularly intense. While such credit requests often

appear justifiable when looked at individually, the aggregate total of credit-financed business spending has tended towards unsustainable levels and has added appreciably to current inflationary pressures. Furthermore, such exceedingly rapid business loan expansion is being financed in part by liquidation of other banking assets and by curtailment of other lending in ways that could contribute to disorderly conditions in other credit markets.

"The System believes that the national economic interest would be better served by a slower rate of expansion of bank loans to business within the context of moderate overall money and credit growth. Further substantial adjustments through bank liquidation of municipal securities or other investments would add to pressures on financial markets. Hence, the System believes that a greater share of member bank adjustments should take the form of moderation in the rate of expansion of loans, and particularly business loans.

"Accordingly, this objective will be kept in mind by the Federal Reserve Banks in their extensions of credit to member banks through the discount window. Member banks will be expected to cooperate in the System's efforts to hold down the rate of business loan expansion--apart from normal seasonal needs--and to use the discount facilities of the Reserve Banks in a manner

consistent with these efforts. It is recognized that banks adjusting their positions through loan curtailment may at times need a longer period of discount accommodation than would be required for the disposition of securities.

"This program is in conformity with the provision in Section 201.0, par. (e) of the Board's Regulation A governing lending to member banks:

'In considering a request for credit accommodation, each Federal Reserve Bank gives due regard to the purpose of the credit and to its probable effects upon the maintenance of sound credit conditions, both as to the individual institution and the economy generally. ...'

"Federal Reserve credit assistance to member banks to meet appropriate seasonal or emergency needs, including those resulting from shrinkages of deposits or of other sources of funds, will continue to be available as in the past.

"A slower rate of business loan expansion is in the interest of the entire banking system and of the economy as a whole. All banks should be aware of this consideration, whether or not they need to borrow from the Federal Reserve. Management of bank resources in accordance with the principles outlined above can make a constructive contribution to sustained economic prosperity, and the Federal Reserve System is confident that the banks will give their whole-hearted support to this effort."